CNG Producing Company

A CNG COMPANY

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LEGAL DEPARTMENT

January 31, 2000

VIA EMAIL – HARD COPY SENT BY FAX

Ms. Lucy Querques Denett
Associate Director, Minerals Management Service
United States Department of the Interior
1849 C Street, NW
Washington, DC 20240

Minerals Management Service Further Supplementary Proposal for Royalty Due on Federal Leases 64 FR 73820 (December 30, 1999)

Dear Lucy:

CNG Producing Company, an active party, strongly supports and adopts as its own the joint comments being filed by the American Petroleum Institute and other industry associations in the referenced proceeding (Joint Comments).

We strongly urge the Minerals Management Service (MMS) to reconsider denying lessees outside the Rocky Mountain area the opportunity to utilize comparable sales and/or comparable purchases in the same area where lease production occurs to establish a valuation benchmark for crude oil not disposed of in arms-length transactions. We still believe it is possible for industry and MMS to reach expeditious agreement on the parameters of acceptable "tendering" programs that would establish a competitive, transparent price for such lease production. Moreover, this valuation alternative would generate the best available pricing information for individual lease production, thereby permitting both the MMS and the lessee to sidestep complex and potentially controversial adjustments to downstream index prices for upstream quality and location differentials. Finally, using such a benchmark would avoid any question that might otherwise arise in the future about the integrity of the pricing information reported in the spot market indices.

We also encourage the MMS to adopt the recommendations contained in the Swanson Energy Group (SEG) report attached to the Joint Comments regarding increasing the allowed rate of return on investment in transportation facilities from one times the Standard & Poor's Industrial BBB bond rate to two times that rate. The rate of return is very significant issue for independent producers, who, increasingly, are operating offshore and making significant investments in pipeline facilities.

CNG further requests MMS 1) to clarify that the same rate of return can be claimed for all royalty bearing substances moved through the same facility, e.g. gas and oil moved in dual phase through one pipeline, and 2) to propose new regulations permitting the same liberalized rate of return to be claimed under the gas valuation regulations. The justification for an increased rate of return applies with equal force to gas pipeline facilities, in which independent producers are making even more significant investments.

Finally, following up on comments made at the recent Houston, Texas workshop, we recommend that the definition of "exchange agreement ", as set forth in proposed 30 CFR §206.101, be modified to **exclude** "exchanges of produced oil for futures contracts". Futures contracts for oil, which are traded on the New York Mercantile Exchange (NYMEX), are entered into by producers, traders and other parties to lock-in a fixed price for a physical commodity to be delivered at a later date. Generally these transactions serve as financial hedges, allowing a producer or other supplier long on the commodity to lock-in a certain price for oil to be delivered and for the counter-party, short on the commodity, to lock-in a fixed price for inventory to be received at a later date.

A futures position must be liquidated on or before the contract expiration date. Most frequently, liquidation occurs by the selling back the contract on the NYMEX; however, for any contract not so liquidated, the NYMEX requires that the physical delivery and receipt of the contract quantity be made at the authorized contract delivery point, e.g. Cushing, Oklahoma, by matched parties (long and short) to the contract.

The NYMEX permits parties having offsetting long and short positions to employ an "exchange of futures for physicals" (EFP) transaction as an alternative means of settling contract obligations "outside the pit". In a typical EFP transaction, the parties with offsetting futures positions will specify that the physical delivery and receipt of the commodity will take place at a physical location away from the authorized delivery point, e.g. delivery and receipt of oil to take place at Midland, Texas, rather than Cushing, Oklahoma. The parties will then report liquidation of their respective contract positions to the NYMEX.

The key point is that the nominal price shown in the EFP transaction is often influenced by factors other than the market conditions prevailing at the time of delivery. For example, if the EFP transaction was entered into significantly in advance of the futures contract expiration date, the stated pricing may reflect the **pricing expectations** in effect at the time the transaction was entered into, not market conditions prevailing at the time of physical delivery. Also, the EFP price may reflect location differentials between Cushing, Oklahoma and the EFP delivery point, as opposed to location differentials between the lease where the oil is produced and the EFP delivery point.

For the above reasons, we recommend that EFP prices be disregarded in valuing lease production. Instead, any production delivered under an EFP transaction should be valued using the applicable index price or such other benchmark as would be available to establish value had a non-arms length transaction been entered into.

We very much appreciate the opportunity to submit these comments.

Very truly yours,

CNG PRODUCING COMPANY

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c: D Guzy